

Message Text

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PAGE 01 QUITO 05523 162226Z
ACTION ARA-14

INFO OCT-01 ISO-00 EB-08 AID-05 CIAE-00 COME-00 FRB-03
INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 FEA-01 ERDA-05 CEA-01
DODE-00 FPC-01 H-01 INT-05 L-03 NSC-05 PM-05
OES-07 SS-15 STR-04 ACDA-07 /117 W
-----058229 162230Z /65

O 161950Z AUG 77
FM AMEMBASSY QUITO
TO SECSTATE WASHDC IMMEDIATE 5417

C O N F I D E N T I A L QUITO 5523

E.O. 11652: GDS
TAGS: ECON XM EC
SUBJ: ECONOMIC ALERT REPORT

REF: STATE 180067

A. MAJOR ECONOMIC PROBLEMS

1. RESTRAINTS ON OIL EXPORTS: IN RESPONSE TO OPEC'S LAST (1976) CALL FOR A PRICE HIKE, THE GOE FIXED AN OVERLY HIGH PRICE FOR OIL EXPORTED BY THE STATE OIL CORP., CEPE. AS A RESULT, CEPE'S OIL EXPORTS--ECUADOR'S MAIN EARNER OF FOREIGN EXCHANGE--HAVE BEEN LAGGING IN 1977. THE GOE IS UNWILLING TO LOWER THE PRICE, FOR POLITICAL REASONS. MOREOVER, CEPE MAY LOSE ITS SALES TO THE US. WEST COAST AS THAT MARKET BECOMES SUPPLIED BY THE ALASKA PIPELINE.

2. LACK OF OIL EXPLORATION: IN 3 OR 4 YEARS, ECUADOR'S GROWING DOMESTIC CONSUMPTION WILL BEGIN TO SUBSTANTIALLY REDUCE THE AVAILABILITY OF ITS OIL FOR EXPORT, AND IN 12 YEARS OR LESS ITS KNOWN OIL RESERVES WILL BE EXHAUSTED. YET THE GOE THUS FAR HAS FAILED TO DEVISE EFFECTIVE INCENTIVES OF FOREIGN COMPANIES TO EXPLORE FOR ADDITIONAL RESERVES, WHICH MAY WELL EXIST. THE GOE
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 QUITO 05523 162226Z

SAYS IT IS WORKING ON NEW CONTRACTUAL INCENTIVES FOR FOREIGN OIL COMPANIES, BUT HAS BEEN SLOW TO PROMULGATE THEM.

3. TEXACO'S ROLE: THE DIFFICULTIES THAT INDUCED GULF TO WITHDRAW FROM THE GULF-TEXACO-CEPE OIL CONSORTIUM RECENTLY ARE FELT AS KEENLY BY TEXACO, BUT TEXACO FOR VARIOUS REASONS HAS DECIDED TO TRY TO STAY ON, AND IS NOW NEGOTIAT-

ING ITS GRIVANCES WITH THE GOE. IF TEXACO SHOULD DEPART, SOONER OR LATER, ECUADOR'S OIL PRODUCTION WOULD SUFFER A SHORT-TERM DISRUPTION, AND PERHAPS MUCH WORSE; AND THE DEPARTURE MIGHT NOT BE AMICABLE. TEXACO, HOWEVER, IS STILL OPTIMISTIC.

4. IMPORT BOOM: WHILE OIL PRODUCTION AND EXPORTS ARE LAGGING, IMPORTS ARE SOARING DESPITE GOE CURBS ON THEM.

5. HEAVY GOE BORROWING: THE GOE IN 1977 HAS BEEN RESORTING TO UNPRECEDENTEDLY LARGE BORROWING, MAINLY FROM COMMERCIAL BANKS. ALTHOUGH THE DEBT-SERVICE RATIO IS STILL LOW (ABOUT 10 PERCENT), THE QUESTION IS WHETHER THE CURRENT RATE OF BORROWING AT HARD TERMS WILL CONTINUE AND EVENTUALLY CAUSE PROBLEMS.

6. COSTLY SUBSIDY ON FUELS: THE GOE HAS LONG SUZEIDIZED DOMESTIC PRICES OF FUELS. HUGE INCREASES IN DOMESTIC CONSUMPTION HAVE RAISED THE SUBSIDY COST TO WELL OVER \$200 MILLION THIS YEAR. BUT THE SLIGHTEST REDUCTION IS BOUND TO TOUCH OFF PUBLIC DEMONSTRATIONS WHICH THE CURRENT LAME DUCK GOVERNMENT WOULD BE LOATH TO PROVOKE. ONE SIGN OF THE BEGINNINGS OF RATIONALITY ON THIS ISSUE: THE GENERAL MANAGER OF CEPE HAS JUST PUBLICLY WARNED THAT THE SUBSIDIES CANNOT CONTINUE INDEFINITELY.

CONFIDENTIAL

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PAGE 03 QUITO 05523 162226Z

B. OUTLOOK FOR NEXT 12 MONTHS (SEE QUITO A-54, "ECONOMIC TRENDS".)

NOTE: THE CURRENT MILITARY GOVERNMENT HAS PROMISED TO EFFECT A RETURN (RETORNO) TO ELECTED, CONSTITUTIONAL CIVILIAN RULE BY MID-1978.

1. BALANCE OF TRADE: THE TRADE DEFICIT IS EXPECTED TO PERSIST WELL INTO 1978; BUT SHOULD IT GROWN WORRISOMELY LARGE, THE GOE WILL SURELY BREAK IT BY TIGHTENING IMPORT CURBS. MOREOVER, OIL EXPORT EARNINGS SHOULD RECOVER IN EARLY 1978, AS OPEC BY THEN WILL HAVE AGAIN RAISED WORLD PRICES AND THE GOE WILL-PRESUMABLY-HAVE SET ITS NEW PRICE AT A MORE COMPETITIVE LEVEL.

2. CAPITAL FLOWS: OFFICIAL BORROWING WILL PROBABLY CONTINUE TO BE VOLUMINOUS, AS THE NEEDS ARE GROWING AND THE LAME-DUCK MILITARY GOVERNMENT IS WILLING TO BUCK PUBLIC CRITICISMS IN ITS ANXIETY TO GET PROJECTS ON TRACK BEFORE IT LEAVES OFFICE. PRIVATE INVESTMENT INFLOWS, ALREADY SMALL, WILL PROBABLY STAY SO AS POTENTIAL INVESTORS WILL BE AWAITING THE OUTCOME OF THE RETORNO AND OF THE ANDEAN

PACT'S TRIBULATIONS.

3. INFLATION: THE GOE'S STAUNCH MEASURES SHOULD SERVE TO KEEP THE INFLATION RATE UNDER 14 PERCENT.

4. LABOR: LABOR'S DEMANDS HAVE LONG BEEN QUASHED BY THE MILITARY REGIME. LEFTIST GROUPS MAY WELL JOIN IN LABOR'S TESTING OF THE ENSUING CIVILIAN ADMINISTRATION'S WILL OR WONT.

5. IN SUME: THE OUTLOOK FOR THE ECONOMY FOR THE NEXT YEAR IS GENERALLY GOOD-PROVIDED THE GOVERNMENT CAN GET ITS OIL EXPORTS MOVING AGAIN.

CONFIDENTIAL

CONFIDENTIAL

PAGE 04 QUITO 05523 162226Z

C. CRITICAL POINTS.

1. EL RETORNO: MUCH WILL DEPEND NOT ONLY ON WHICH PARTIES COME TO POWER BUT ALSO ON HOW THE PRESENT REGIME CHOOSES TO BOW OUT. ONE DANGER IS THAT THE MILITARY MAY GO OVERBOARD IN TRYING TO GET PROJECTS ON TRACK TO PREEMPT A NEGATIVE DECISION BY THE ENSUING CIVILIAN GOVERNMENT. ANOTHER DANGER IS THAT THE MILITARY WILL LEAVE IT TO THE CIVILIANS TO MAKE CERTAIN DECISIONS THAT CAN'T WAIT (E.G., SEE C-4 BELOW).

2. PERUVIAN PERIL: THE MILITARY AND MUCH OF THE ECUADOREAN PUBLIC REMAIN CONVINCED THAT PERU IS ON A WARPATH. ANY FURTHER SIGNS FROM PERU THAT THAT CONVICTION IS CORRECT WILL GENERATE PRESSURES FOR FURTHER BUDGETARY DIVERSIONS TO ARMS PURCHASES.

3. ANDEAN PACT: IF THE ANDEAN PACT FAILS TO RESOLVE ITS LATEST CRISIS (RE AUTO ASSIGNMENTS) OR SOME FUTURE ONE IN THE UNENDING SERIES, ECUADOR'S POTENTIAL FOR INDUSTRIALIZATION VIA INVESTMENT AND EXPORTS WILL BE GREATLY DMINISHED.

4. OIL: THE OUTGOING MILITARY AND THEIR SUCCESSORS MUST MAKE SOME CRUCIAL DECISIONS RE TOPICS -1,2,3 AND 6 ABOVE. A WRONG DECISION ON ANY OF THESE COULD BE EXCEEDINGLY DAMAGING, AND ON A-3 COULD AGGRIEVE THE USG.

5. EMBASSY REGRETS THAT TRANSMITTAL OF THIS MESSGAE WAS DELAYED BECAUSE OF WORKLOAD IMPOSED FOR TWO CODELS WHICH VISITED QUITO AUGUST 11-13.
BLOOMFIELD

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC REPORTS, ECONOMIC TRENDS
Control Number: n/a
Copy: SINGLE
Sent Date: 16-Aug-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977QUITO05523
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D770295-1113
Format: TEL
From: QUITO
Handling Restrictions: n/a
Image Path:
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Litigation History:
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Office: ACTION ARA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
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Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 77 STATE 180067
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 19-Jan-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1588375
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC ALERT REPORT
TAGS: ECON, XM, EC
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/2ad3f759-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009